

Current State Tax Issues for Cloud Computing and Digital Goods

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The logo for Sutherland, featuring the word "SUTHERLAND" in white, uppercase, sans-serif font, centered within a blue rectangular box. A thin, light brown horizontal line is positioned directly beneath the blue box.

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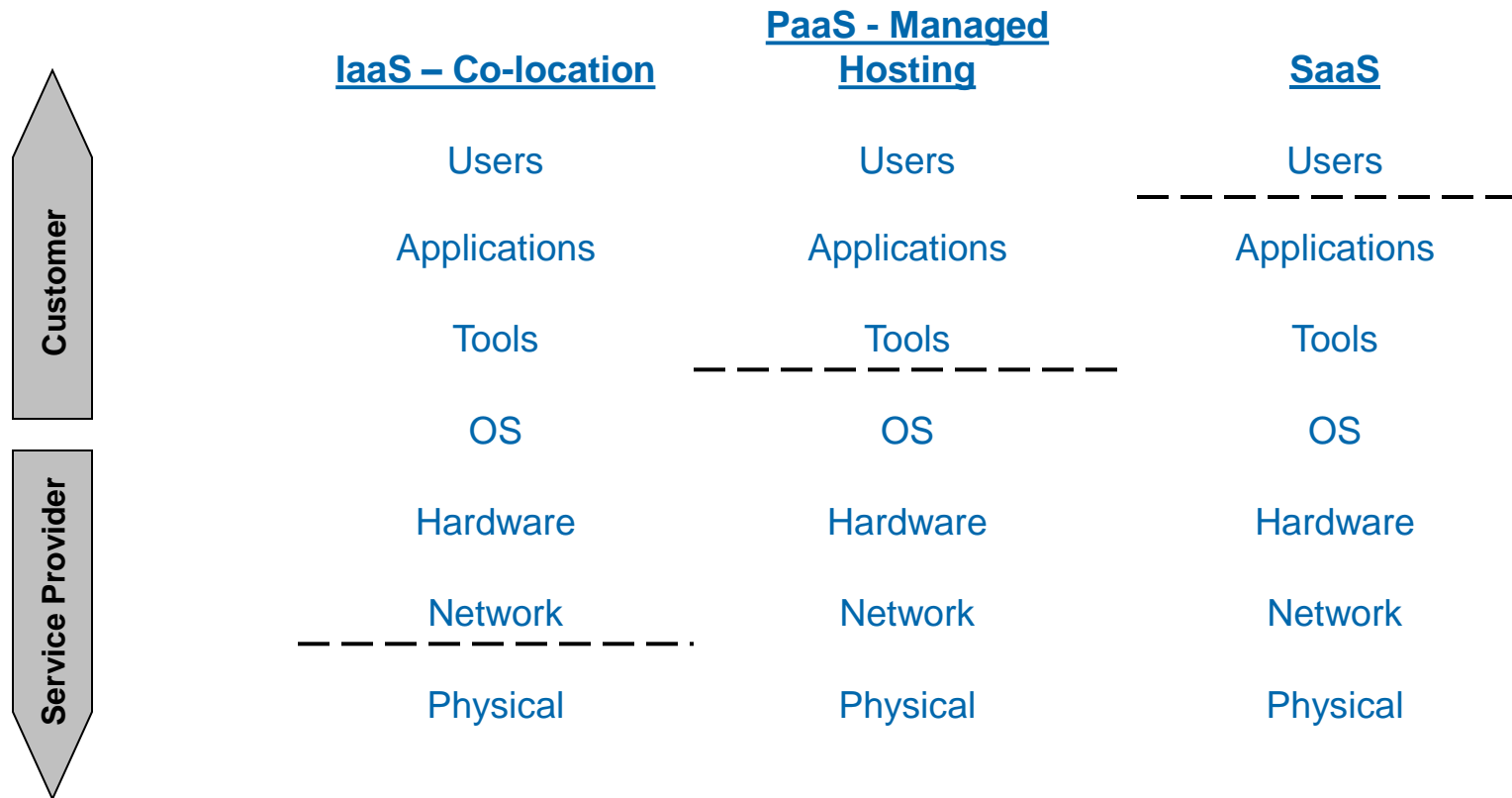
- Overview of Tax Issues
 - Characterization Determines Taxability
 - Sourcing
 - Arizona
- Federal Legislation
 - Legislative Overview

What is being sold?

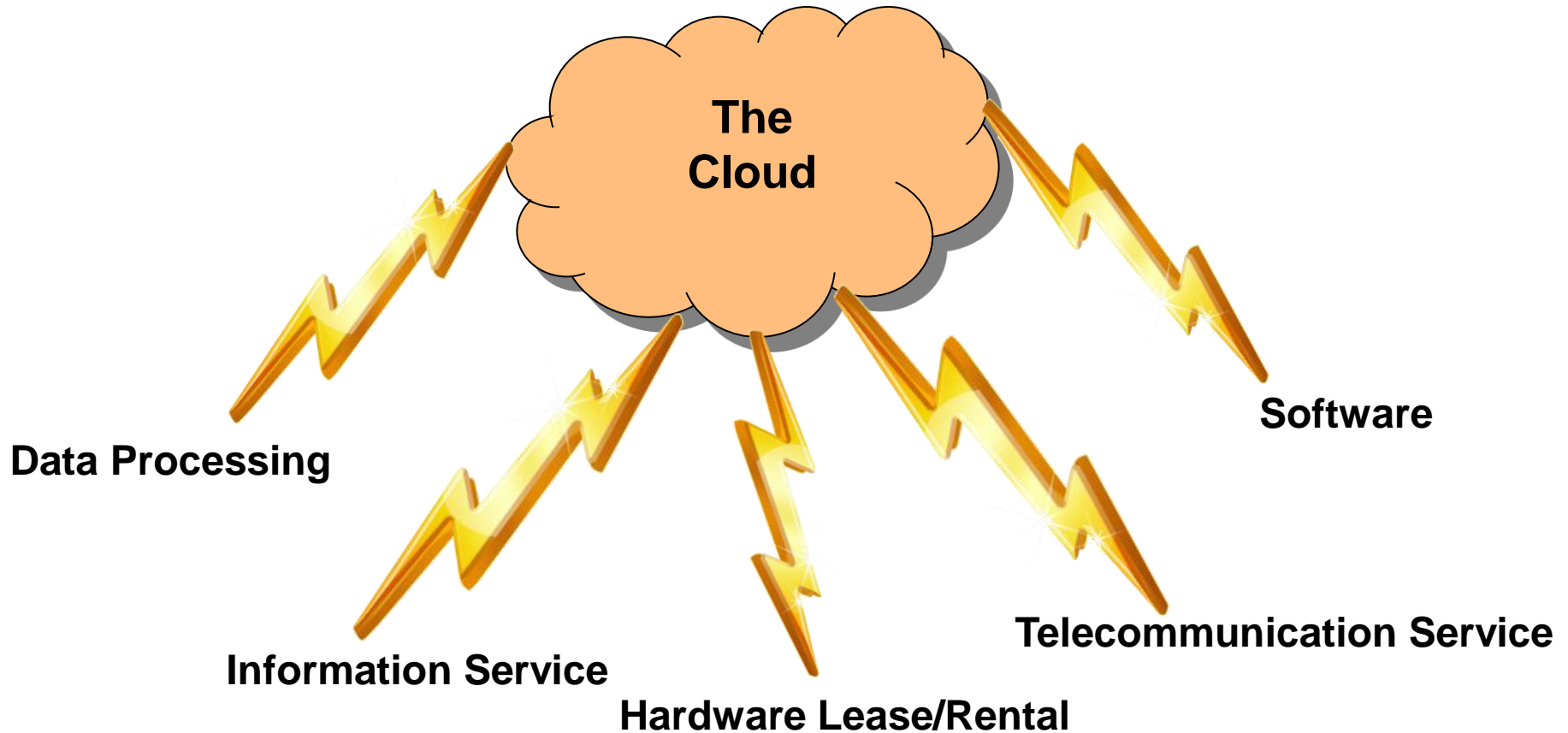
- Understanding the products and services
 - Object of the transaction
 - Digital Goods
 - Data Processing
 - Information Services
 - Software
 - Prewritten v. Custom
 - Application Service Providers/Cloud Computing
 - Software as a Service (SaaS)
 - Method of delivery
 - Tangible
 - Electronic
 - Load-and-Leave
 - Remote Access

- **Software as a Service (SaaS)**
 - Also referred to as “Application Service Provider” or ASP
- **Platform as a Service (PaaS)**
 - A specialized form of SaaS
- **Infrastructure as a Service (IaaS)**
 - Focus is on hardware, networking, etc. rather than the software application
- **Unified Communications as a Service (UCaaS)**
 - Integrates communications services (i.e. voice, chat, video conferencing) with messaging (i.e. voicemail, email) hosted by a service provider through the cloud

Cloud Service – Division of Ownership



----- Indicates separation between Provider and Customer

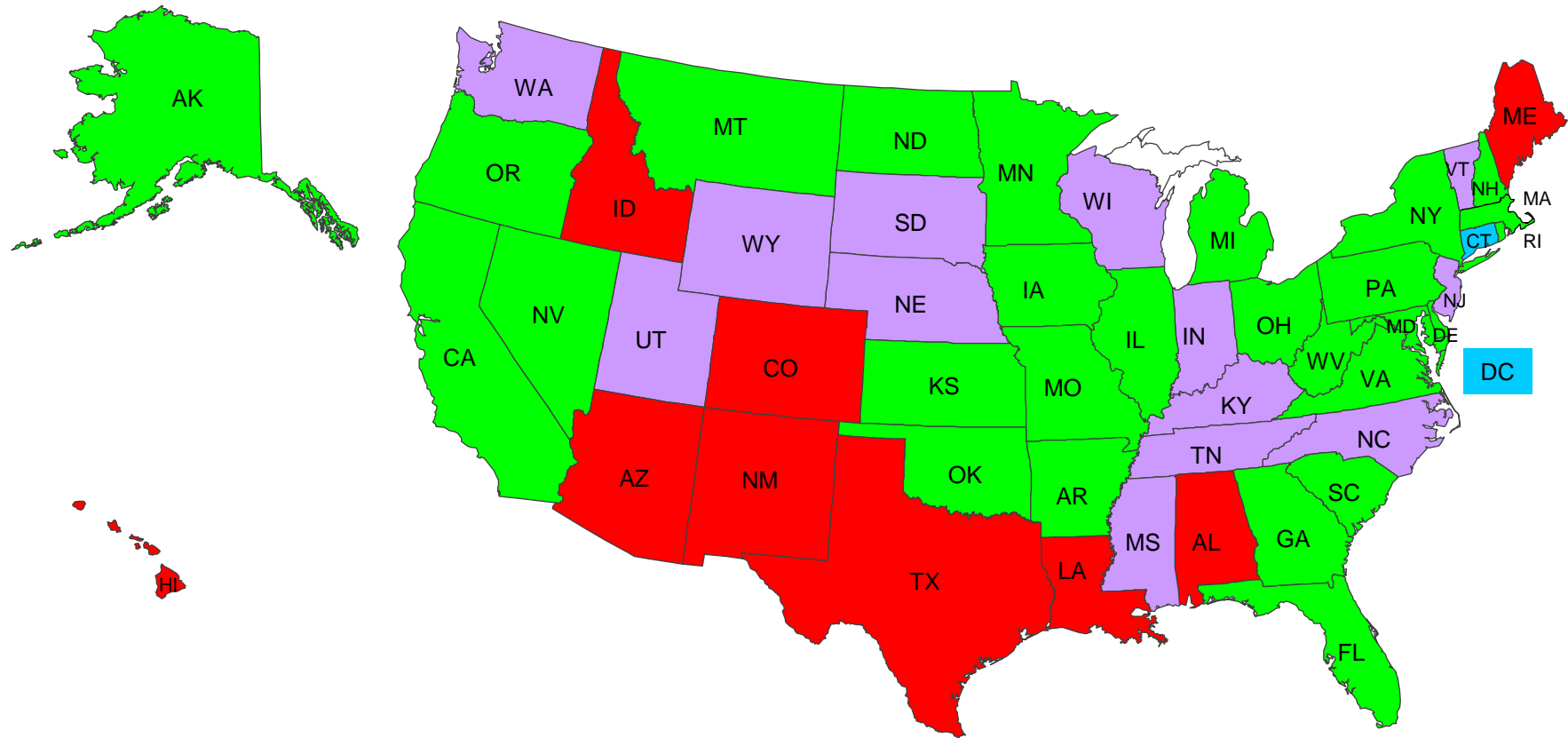


Most Cloud Computing offerings do not fit neatly into traditional state tax categories

- State taxability positions range from:
 - Not an enumerated taxable service and Not tangible personal property
 - Taxable service
 - Information service – NY
 - Data processing service – TX, OH
 - Digital automated service – WA
 - Computer-related services – CT
 - Communication service – SC
 - Taxable rental if software resides on a server in the state – KS, FL (previously UT)
 - Taxable or Not Taxable “Computer Time Sharing” arrangement – FL, CA

States of Confusion – Taxability of Digital Goods

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Digital Goods Taxed by DOR
Position or Caselaw
As Tangible Personal
Property

Digital Goods Taxed by DOR
Position or Caselaw
Information Service

Digital Goods
Non-Taxable

Digital Goods Taxed
by Statute

- If Cloud Computing transactions are taxable, in which state or states should the transaction be taxed?
- States generally use one of two methods for sales tax sourcing:
 - Origin-based sourcing – sourced to the location where the product or service originates
 - Destination-based sourcing – sourced to the location where the product or service is ultimately consumed
 - But how does a seller know where customers' employees are located when accessing the cloud?

- Guidance from the Arizona DOR indicates that digital property that can be stored on tangible storage media is included in the definition of “tangible personal property” and thus subject to tax. See Arizona Private Taxpayer Ruling LR05-010, 09/26/2005.
- No administrative rules regarding sale of digital goods has been issued.

- Arizona has issued guidance that “software licensing” in a cloud computing environment is the taxable lease of software. Arizona Letter Ruling 10-007 (March 24, 2010).
- The ruling letter does not address the broader concept of cloud computing but only the software license.
- Maintains that it is irrelevant whether an actual license is sold or merely the temporary use of software is provided.
- Sourcing to user location, thus requiring apportionment of receipts

Digital and Cloud Legislative Activity

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- While in the previous decade states focused on taxing digital goods (movies, songs, books), this decade has seen great interest by state legislatures and administrative agencies in cloud computing services
 - Nearly every new budget introduced includes cloud computing provisions, primarily targeting SaaS. Recent examples are CT, RI, and MD. These efforts have failed due to economic development concerns.

- Washington State

- Engaged in a detailed and thoughtful process with business input that resulted in the enactment of a broad tax on “Digital Automated Services” and a separate imposition on “Remote Access Software.”

- Vermont

- Similar to Arizona, Vermont’s Department of Taxation taxed cloud computing by administrative rulings rather than statute. The legislature enacted a moratorium on that tax and ordered the DOT to refund any taxes paid retroactive to 2006.
- A commission has been engaged to recommend changes to be enacted effective July 2013.

Federal Effort - The Digital Goods and Services Tax Fairness Act

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- H.R.1860/S. 971
- What the measure *does* –
 - Establishes a national framework –
 - Uniform sourcing rules
 - Precludes discriminatory and multiple taxes
 - Establishes clarity for –
 - the consumers purchasing these new innovative services
 - states and local governments seeking to impose taxes on these new goods and services
 - the businesses that act as tax collectors on behalf of the states and localities

Questions?

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